OTHER COMPREHENSIVE INCOME

2017 Insurance IFRS Seminar

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Other Comprehensive Income

- Other Comprehensive Income is not included in insurance service results nor insurance finance income or expenses.
- A way to remove "X" from impacting the income statement but still have it show up in the balance sheet and statement of comprehensive income
- "X" could be:
  – Spurious or short term volatility
  – An accounting mismatch
  – Something that is not part of the core underlying earnings
  – Something a company wishes was not part of the core underlying earnings

Why are we discussing OCI

- The ED required **all** the movements in liabilities be recognized in income statement and that these liabilities be measured at **current values**.
- Most of the users and preparers agreed with the measurement but not the reporting:
  - Recognition of short-term volatility in profit or loss caused by changes in discount rate does not reflect the long-term nature of the insurance liability
  - These short-term impacts will naturally reverse over time as claims are ultimately paid
  - It will obscure the underlying long-term performance
- They therefore suggested that short-term volatility caused by changes in discount rate should be presented in OCI
  - Others notes this would help make insurers more comparable to other industries

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OIC approach is optional

- OCI approach is optional in IFRS 17.
- 2013 ED proposed the mandatory use of OCI to present the effect of changes in discount rates on the measurement of insurance contracts.
- However, if OCI is mandatory, potential accounting mismatches:
  - In equity if the assets backing insurance liabilities are measured at amortised cost
  - In P&L in respect of assets backing insurance liabilities measured at fair value through profit or loss (FVPL)
  - In P&L upon the sale of assets measured at FVOCI and amortised cost
  - In P&L if the assets backing insurance liabilities are equity instruments held at FVOCI
- Disclosures are required on impact of current vs locked-in rate.

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Liability OCI is calculated as

Other Comprehensive Income

Present value of projected cash flows using current discount rates — Present value of projected cash flows using initial recognition discount rates

Objective of OCI

- Provide information that faithfully represents the financial performance by segregating the effects of underwriting performance from the effects of changes in discount rates.
- The impact of interest rate fluctuations should not be reflected in profit or loss as these will unwind.
- IFRS 9 introduces a new category 'fair value through OCI' for bonds.

Accounting policy choice to present changes in discount rates in P&L or OCI – consistent application at portfolio level.

Accounting treatment

- Changes in insurance liability arising from changes in discount rate and financial risk could be presented in OCI.
- The OCI solution applies to both the coverage and claims handling periods.
- Apply the OCI accounting policy choice at **portfolio** level.

Accounting treatment (cont.)

Insurance finance inc/exp	Option 1	Option 2	Allocation method under Option 2
Direct par contract when entity holds underlying item	100% P&L	P&L/OCI	Include in P&L an amount that **eliminates accounting mismatches** with finance income or expenses from the underlying items
All other contracts	100% P&L	P&L/OCI	Include in P&L an amount determined by a **systematic allocation** of the expected total finance income or expenses over the duration of the contracts

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Accounting treatment (cont.)

Eliminate accounting mismatches

- Include in P&L expenses/income that exactly match the income/expenses included in the P&L for the underlying items, resulting in nil finance results.

Systematic allocation

- Is based on characteristics of the contracts, without reference to factors that do not affect the cash flows expected to arise under the contracts.
- Results in the amounts recognized in OCI over the duration of the contracts totalling zero.

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A change in holding of underlying items

What

- A change in “whether the entity holds the underlying items” means the entity that used to hold the items no longer holds them or the entity did not hold the items now hold them.
- IFRS 17 requires the entity to move from “systematic allocation” to “eliminate accounting mismatch” or vice versa.

How

- Include the accumulated amount previously included in OCI as a **reclassification adjustment in P&L**.
- The amount previously included in OCI is not recalculated.
- Prior period comparative is not required.

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Issues and practical considerations

Issues

- FVOCI will be available for debt instruments, but accounting mismatches may not be entirely eliminated
  - Assets at amortised cost or FVTPL
  - Where derivative is used to manage risk, change in fair value is recognised in P&L

Practical consideration

- Two sets of liability balance need to be stored (at locked-in interest rates and current interest rates)
- Duration gap is real economic mismatch.

Interaction with asset accounting

Asset Accounting	Liability Accounting	P&L	Net Assets
Amortised cost	OCI	Stable	Volatile
FVTPL	OCI	Volatile	Stable
FVOCI	OCI	Stable	Stable
Amortised cost	P&L	Volatile	Volatile
FVTPL	P&L	Stable	Stable
FVOCI	P&L	Volatile	Stable

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